NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

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Monetary Policy Decision

The Reserve Bank of Tonga Board approved at its monthly meeting on the 27th April 2017 to maintain the current accommodative monetary policy stance. This is to encourage the utilisation of the excess liquidity in the banking system to increase lending in order to support economic growth and strengthen the monetary policy transmission mechanism. The following are the accommodative monetary policy measures:-

a. maintain the monetary policy rate at 0% (zero interest rate policy);
b. maintain the minimum loans/deposit ratio of 80%;
c. maintain the Statutory Reserve Deposit ratio at 10% effective in July 2017; and
d. maintain the inflation reference rate at 5%.

The Acting Governor of the Reserve Bank, Jessie Cocker in announcing the Board decision highlighted that the domestic economy picked up in February after slow growth was recorded in the previous month. This trend is similar to previous years. The recovery was supported by an improved agricultural sector, on-going construction works and positive growth in the distribution sector. The foreign reserves on the other hand fell over the month to $377.7 million due to the deficit in the Overseas Exchange Transactions (OET) overall position. This is equivalent to 7.1 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months. The annual inflation rate increased significantly by 8.9% in the year ended February 2017. This was due mainly to the new customs duty and excise tax introduced in July 2016 which largely drove the 10.5% rise in imported prices. Annual domestic inflation rate also rose by 6.8% due mainly to the continued short supply of kava-Tonga and volatile local food prices.

The banking system remained sound with strong capital position maintained, supported by comfortable profitability, and non-performing loans continued to remain low. The lower deposits in February coincided with the fall in the foreign reserves and rise in net domestic assets. The loans to deposit ratio of banks remained below the 80% minimum loan to deposit ratio target which indicated excess liquidity in the banking system remains and that more capacity for further lending by the banks exists.

On the outlook, the Reserve Bank's expectation for strong economic activity remains in the near term. The level of foreign reserves is also projected to remain adequate supported by estimated higher receipts of remittances and foreign aid and this will be partially offset by the expected increase in imports. Upward inflationary pressure remains in the near term due mainly to the impact of the amendments made to custom duty and excise tax effective on 1st July 2016, however it is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum in 2017/18.

The Acting Governor concluded that the Reserve Bank will continue to closely monitor developments in the domestic and global economy, and update its monetary policy setting to maintain internal and external monetary stability, and to promote a sound and efficient financial system in order to support macroeconomic stability and economic growth.

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[1] Methodology used for this calculation has changed to include both imports of goods and services whilst the calculation used in previous reports used import of goods only

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